

Responding to our
customers' needs is a
24 hour a day commitment.



NCB encourages education and is a major contributor to many community projects. NCB sponsored the King Abdul Aziz University computer laboratory and is keen on supporting similar projects with other educational institutions.

As befits a major regional player, NCB participated in a number of international events during 1997, including conferences held by the IMF in Hong Kong and SIBOS in Sydney. We also participated in the Bank Technologies Exhibition in Riyadh and sponsored the Gulf Economic Forum in Bahrain and the Arab Capital Markets Seminar in Beirut and Horizon 2000 Arab Banking Summit in London.

The arrival of NCB's dedicated Intranet has provided a superb opportunity to maximise the internal communications process. As a source of news and information, the Intranet encourages an effective interchange of ideas between offices and branches, at all levels.

Our interaction with the community is a two-way process in which The National Commercial Bank has a responsibility to support worthwhile and deserving causes. Charitable donations, amounting to SR 86,673,000 were made during the course of 1997.

In conclusion, it has been a defining year, in which NCB has emerged as a Joint Stock Company with the skills and technology to fulfil the expectations and needs of our customers, business partners, employees and shareholders, as we continue to serve the Kingdom of Saudi Arabia and its people.

To the Shareholders of The National Commercial Bank

We have audited the balance sheet of The National Commercial Bank (the "Bank") (as a Saudi Joint Stock Company) as of 31 December 1997 and the related statements of income, changes in shareholders' equity, and cash flows for the year then ended, including notes 1 to 27 which form part of these financial statements. These financial statements, which have been derived from computerised accounting records maintained in Arabic in the Kingdom of Saudi Arabia, are the responsibility of the Bank's management and have been prepared by them in accordance with the provisions of the Regulations for Companies and the Banking Control Law and submitted to us together with all the information and explanations which we required. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit

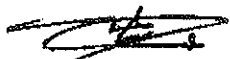
includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Bank's management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable degree of assurance to enable us to express an opinion on the financial statements.

In our opinion, the financial statements taken as a whole:

—present fairly, in all material respects, the financial position of the Bank as of 31 December 1997 and the results of its operations and its cash flows for the year then ended in accordance with Accounting Standards for Commercial Banks issued by the Saudi Arabian Monetary Agency and International Accounting Standards; and

—comply with the requirements of the Regulations for Companies, Banking Control Law and the Bank's Articles of Association in so far as they affect the preparation and presentation of the financial statements.

Whinney Murray & Co



Dr Abdullah Abdulrahman Baeshen
Registration No. 66



Al Sayed El Ayouty & Co
Accountants and Auditors



Al Sayed El Ayouty
Registration No. 36



Balance sheet

as at 31 December 1997 (in thousands of Saudi Riyals)

Assets	Note	1997	1996
Cash and balances with SAMA	3	2,899,160	2,620,947
Due from banks	4	14,144,783	12,678,095
Trading securities	5	1,320,500	1,314,678
Loans and advances, net	6 & 22	46,290,109	38,171,072
Investment securities, net	7	16,863,104	20,467,240
Fixed assets, net	8	1,702,017	1,713,133
Other real estate	9	1,030,880	1,033,182
Other assets	10	2,187,589	2,054,241
Total assets		86,438,142	80,052,588
Liabilities and shareholders' equity			
Liabilities			
Customers' deposits	11 & 22	61,929,185	58,004,080
Due to banks	12	13,919,435	11,430,821
Other liabilities	13	2,802,766	2,962,847
Total liabilities		78,651,386	72,397,748
Shareholders' equity			
Share capital	14	6,000,000	6,000,000
Statutory reserve	15	1,761,695	1,500,871
Retained earnings		25,061	153,969
Total shareholders' equity		7,786,756	7,654,840
Total liabilities and shareholders' equity		86,438,142	80,052,588
Contra accounts	19.2 & 22	87,816,418	124,192,701

Statement of income

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as at 31 December 1997 (in thousands of Saudi Riyals)

	Note	1997	1996
Operating income			
Special commission income		3,711,756	3,618,593
Gains on foreign exchange		115,057	91,986
Gains on trading securities		91,783	77,089
Income from investment securities		1,278,691	1,168,885
Income from other real estate	20	27,543	25,433
Fees and income from banking services		450,453	338,318
Total operating income		5,675,283	5,320,304
Operating expenses			
Special commission cost		2,613,597	2,432,835
Provision for loan losses	6	450,494	450,614
Salaries and other staff related costs		864,536	819,208
Depreciation of fixed assets and other real estate	8 & 9	162,105	143,408
Other general and administrative expenses		608,978	505,158
Total operating expenses		4,699,710	4,351,223
Net operating income		975,573	969,081
Other income (expenses)			
Other income	21	166,394	19,292
Donations and charitable contributions		(86,673)	(49,079)
		79,721	(29,787)
Net income before Zakat		1,055,294	939,294
Zakat	18	(12,003)	(24,287)
Net income		1,043,291	915,007
Earnings per share (SR)	16	17.4	

The attached notes 1 to 27 form part of these financial statements.

Statement of changes in shareholders' equity

for the year ended 31 December 1997 (in thousands of Saudi Riyals)

	Note	Share capital	Statutory reserve	Retained earnings
1997				
Balance at beginning of the year		6,000,000	1,500,871	153,969
Movement during the six months ended 30 June 1997:				
Net income	17	-	-	590,262
Transfer to statutory reserve	15	-	147,566	(147,566)
Profit distributed to partners		-	-	(596,665)
Balance		6,000,000	1,648,437	-
Movement during the six months ended 31 December 1997:				
Net income		-	-	453,029
Transfer to statutory reserve	15	-	113,258	(113,258)
Proposed dividend and zakat	18	-	-	(314,710)
Balance at end of the year		6,000,000	1,761,695	25,061
1996				
Balance at beginning of the year		6,000,000	1,272,120	216
Net income		-	-	915,007
Transfer to statutory reserve	15	-	228,751	(228,751)
Profit for distribution to partners		-	-	(532,503)
Balance at end of the year		6,000,000	1,500,871	153,969

The attached notes 1 to 27 form part of these financial statements.

Statement of cash flows

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for the year ended 31 December 1997 (in thousands of Saudi Riyals)

Cash flows from operating activities	Note	1997	1996
Net income		1,043,291	915,007
Adjustment of net income to net cash flow from operating activities:			
Depreciation of fixed assets and other real estate		162,105	143,408
Gains on disposal of fixed assets		(1,175)	(1,066)
		1,204,221	1,057,349
Net (increase)/decrease in operating assets:			
Due from banks		(1,466,688)	504,902
Trading securities	5	(193,322)	(1,044,391)
Loans and advances – net		(8,119,037)	(1,195,176)
Other real estate		(5,826)	(151,592)
Other assets		(133,348)	(57,742)
Increase in operating liabilities:			
Customers' deposits		3,925,105	2,083,665
Due to banks		2,488,614	638,476
Other liabilities		101,814	280,729
Net cash (used in)/from operating activities		(2,198,467)	4,506,572
Cash flows from investing activities			
Net decrease/(increase) in investment securities	5	3,791,636	(3,992,467)
Purchase of fixed assets		(195,999)	(224,459)
Proceeds from disposal of fixed assets		10,211	19,353
Net cash from/(used in) investing activities		3,605,848	(4,197,573)
Cash flows used in financing activities			
Profits distributed		(1,129,168)	(525,000)
Net increase/(decrease) in cash and balances with SAMA		278,213	(216,001)
Cash and balances with SAMA at beginning of the year		2,620,947	2,836,948
Cash and balances with SAMA at end of the year		2,899,160	2,620,947

The attached notes 1 to 27 form part of these financial statements.

for the year ended 31 December 1997

1. General

The National Commercial Bank (the Bank) was established as a general partnership by a registration certificate certified by a Royal Decree in Rajab 1369 H (corresponding to May 1950) and was registered under the commercial registration No. 1588 in Dhul Hijjah 1376 H (corresponding to July 1957).

The partners of the general partnership resolved in their meeting dated 7 Dhul Qida 1417 H (corresponding to 16 March 1997) to convert the Bank from a General Partnership to a Joint Stock Company and admit new shareholders. A Cabinet Resolution No. 186 dated 22 Dhul Qida 1417 H (corresponding to 30 March 1997) and Royal Decree No. M/19 dated 23 Dhul Qida 1417 H (corresponding to 31 March 1997) approved the Bank's conversion to a Saudi Joint Stock Company. The legal formalities in respect of the conversion have been completed and the Bank's Articles of Association have been published in Um Al Qura, edition number 3653 dated 19 Safar 1418 H (corresponding to 24 June 1997).

The objectives of the Bank are to provide all banking services. The Bank operates through 245 branches (1996 - 253 branches) in the Kingdom of Saudi Arabia and 2 branches overseas (Beirut and Bahrain).

The Bank has 60% ownership in a subsidiary, the Commercial Real Estate Markets Company, a Limited Liability Company registered in Saudi Arabia under commercial registration number 4030073863 dated 5 Rabi Thani 1411 H (corresponding to 24 October 1990). The company is engaged in owning, maintaining and managing the Jamjoom Centre in Jeddah. The financial statements of the subsidiary have not been consolidated with the Bank's financial statements on the grounds that the activities of the subsidiary are dissimilar to the Bank's activities. This subsidiary has been accounted for on equity basis and included in investment securities.

2. Summary of significant accounting policies**2-a) Regulatory requirements**

The Bank is subject to the Regulations for Companies and the Banking Control Law in the Kingdom of Saudi Arabia. The financial statements are prepared in accordance with Accounting Standards for Commercial Banks issued by the Saudi Arabian Monetary Agency (SAMA), the requirements of the Regulations for Companies, the General Presentation and Disclosure issued by the Ministry of Commerce and comply with International Accounting Standards.

2-b) Financial year

Article 40 of the Bank's (A Saudi Joint Stock Company) Articles of Association provides that the financial year of the Bank is the Gregorian calendar year and the first financial year to include the period commencing from the date of conversion of the Bank to a Joint Stock Company to the end of December of the same year. Pursuant to an agreement signed on 30 June 1997 amongst the shareholders, 1 July 1997 was specified to be the effective date of the Bank's conversion from a general partnership to a Joint Stock Company. Accordingly, these financial statements have been prepared on a full year basis, and include the period from 1 January 1997 to 30 June 1997, which is the period prior to the conversion date and has been approved by the concerned authorities (Note 17).

2-c) Accounting convention

The financial statements are prepared under the historical cost convention.

2-d) Trading and investment securities portfolios

The Bank maintains two separate and distinct securities portfolios, namely 'investment securities' and 'trading securities'. The designation is made by the Bank's management between the two portfolios at the time of purchase and no transfers are made between them after such date unless the management has justifications for such transfers. On 1st January 1997, the Bank's management transferred certain trading securities to the investment portfolio at the cost of acquisition, which is equivalent to market value of these securities at that date. The Bank's management had the intention to hold these investments as a long term investment due to their good quality and potential low risk (note 5).

(i) Trading securities

Securities purchased for trading purposes are recorded at cost of acquisition at the date of purchase and are marked to market at the balance sheet date. The realized and unrealized gains or losses are included in income from operations. Income from these securities is classified as other income (expenses).

(ii) Investment securities

Investment securities are stated in the balance sheet at cost adjusted for amortization of premiums and accretion of discounts, when applicable, net of provision for permanent decline in value. Investment in a subsidiary is accounted for on equity basis. Amortization and accretion are computed using the straight line method over the remaining maturity period. The amortized premium and discount and the income earned by the Bank on these securities are included in operating income.

In case of a permanent diminution in the value of any individual security, a provision is made for the amount of diminution. Such provision, as well as gains and losses arising on disposal of investment securities, are classified as other income/(expense).

Notes to the financial statements

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for the year ended 31 December 1997

2-e) Provision for loan losses

Provision is made against specific loans and advances following a study of the portfolio that takes into account the recoverability of those debts and the general economic conditions. Such provision is charged to operating expenses.

Loans and advances are written off only in circumstances where all possible means of collection have been exhausted and after taking into account the guarantees provided in respect of such loans.

Provision for loan losses is deducted from loans and advances in the balance sheet.

2-f) Fixed assets

Fixed assets are stated in the balance sheet at cost net of accumulated depreciation.

Freehold land is not depreciated. The cost of other fixed assets is depreciated using the straight-line method over their expected useful lives, based on the following annual percentage rates:

Buildings	2.5%
Furniture, cars and equipment	10% to 25%
Cost of buildings on leasehold land	over the lease period.

2-g) Other real estate

The Bank occasionally acquires real estate against settlement of overdue loans and advances. Such real estate is recorded at the lower of current market value of the acquired real estate or the present value of outstanding loan or advance at the settlement date.

Other real estate is valued periodically by independent appraisers. The unrealized loss arising on periodical valuations of other real estate and gains/losses on disposal are included in operating income.

The cost of buildings included under other real estate is depreciated using the straight-line method at an annual rate of 2.5%. Other real estate is stated in the balance sheet net of accumulated depreciation and provision for decline in book value.

2-h) Income recognition

Income and expenses are recognized on an accrual basis. However, income on loans and advances classified as non-performing is recognized on a cash basis until the loan or advance is reclassified as performing whereupon the recognition of income reverts to an accrual basis.

Income from Islamic products is recognized on an accrual basis except for income from musharakah transactions which is recognized on a cash basis.

2-i) Foreign currencies

Transactions in foreign currencies are translated to Saudi Riyals at the exchange rates prevailing on the dates of the transactions. Assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Saudi Riyals at the rates of exchange prevailing at that date. Realized and unrealized gains and losses on exchange are credited or charged to operating income.

2-j) Financial Instruments

Financial instruments include both on and off balance sheet instruments

2-j-1 On balance sheet financial instruments

On balance sheet financial instruments comprise cash and balances with SAMA, due from banks, trading securities, loans and advances, investment securities, certain other assets, customer deposits, due to banks and certain other liabilities.

The fair values of on balance sheet financial instruments, except for investment securities and loans and advances, are not significantly different from the carrying values included in the financial statements. The fair value of the investment securities is based on quoted market prices when available, pricing models in the case of certain fixed rate bonds and estimated fair values for non quoted securities. It is not practical to determine the fair value of loans and advances to customers with sufficient reliability.

The maximum credit risk from on balance sheet financial instruments is equal to the carrying value disclosed in the financial statements excluding fair values of collateral received.

for the year ended 31 December 1997 (in thousands of Saudi Riyals)

2. Summary of significant accounting policies continued**2-j-2 Off balance sheet financial instruments (contra accounts)**

Off balance sheet financial instruments comprise letters of credit, letters of guarantee, commitments to purchase and sell foreign currencies, interest rate and foreign currency related swaps, forward rate agreements, currency options, futures and other miscellaneous contingent liabilities.

The Bank enters into forward and future transactions, swaps and options to hedge the risks accompanying the management of its assets and liabilities, or for trading purposes. Trading transactions are also undertaken to service customer needs.

Forward foreign exchange contracts are recorded in Saudi Riyals at the spot rates prevailing at the deal date. Premiums and discounts relating to the forward foreign exchange contracts are amortized or accredited on a straight line basis over the period of the contract. Contracts outstanding at the balance sheet date are valued at the spot exchange rate prevailing at that date. Realized and unrealized gains and losses on exchange are credited or charged to operating income.

Financial instruments concluded to hedge asset and liability risks are treated in the same manner as that adopted in respect of the item hedged. Commission income/expense from such instruments is included in operating income. Transactions concluded for trade purposes are marked to market; realized and unrealized gains or losses are included in operating income.

The fair value of off balance sheet financial instruments is determined on the basis of market values. The maximum credit risk from off balance sheet financial instruments is substantially less than the carrying values in the balance sheet excluding fair values of collateral received.

2-j-3 Offsetting of financial assets and liabilities

Financial assets and liabilities are offset and reported net in the accompanying balance sheet when a legally enforceable right to set off the amounts exists or when the Bank intends to settle on a net basis or to realize the asset and settle the liability simultaneously.

2-j-4 Risk management

As part of the Bank's strategy, the Bank's management controls risks associated with financial instruments by hedging risk exposures, avoidance of undue concentration of risk and requirements for collateral to mitigate credit risks.

2-k) Employees' end of service benefits

Benefits payable to the employees of the Bank are provided for in accordance with the guidelines set by the Saudi Arabian Labour Law and are included in other liabilities.

2-l) Zakat

Zakat is the liability of the shareholders and is paid by the Bank on their behalf. Zakat is computed in accordance with the Regulations of the Department of Zakat and Income Tax based on the financial statements and is charged to the statement of retained earnings. Up to 30 June 1997 and prior to the conversion of the Bank to a Joint Stock Company, zakat was charged to the statement of income.

3. Cash and balances with SAMA

	1997	1996
Cash on hand	790,174	589,283
Balances with SAMA		
Statutory deposit	2,086,563	2,010,158
Current accounts	22,423	21,506
Total cash and balances with SAMA	2,899,160	2,620,947

In accordance with Article (7) of the Banking Control Law, the Bank is required to maintain a statutory deposit with SAMA at stipulated percentages of its call, time, savings and other deposits determined at the end of each Gregorian month.

4. Due from Banks**a) Domestic**

	1997	1996
Call and current accounts	466,806	269,995
Time deposits	1,790,030	2,106,118
	2,256,836	2,376,113

b) Foreign branches of domestic banks

Time deposits	150,000	416,250
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c) International

Call and current accounts	1,263,040	974,581
Time deposits	10,474,907	8,911,151
	11,737,947	9,885,732

Total due from banks	14,144,783	12,678,095
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Notes to the financial statements

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for the year ended 31 December 1997 (in thousands of Saudi Riyals)

	1997	1996
5. Trading securities		
a) Domestic		
Quoted shares	-	16,634
Units in investment funds managed by the Bank	188,913	74,085
Fixed rate Government bonds	169,895	-
	358,808	90,719
b) International		
Externally managed portfolios (shares, bonds and others)	961,692	1,223,959
Total trading securities (at market value)	1,320,500	1,314,678

At 1 January 1997, the Bank's management transferred certain securities amounting to US\$ 50 million (equivalent to SR 187.5 million) previously purchased as trading securities to the investment securities portfolio (note (2) d).

The cost of acquisition of trading securities as at 31st December 1997 amounted to SR 1,238 million (1996 - SR 1,224 million). The net unrealized gains on the trading portfolio resulting from marked to market valuation during the year amounted to SR 82.5 million (1996 - SR 70.9 million).

6. Loans and advances, net

6-1 Loans and advances comprise the following:

	1997	1996
Loans and advances, gross	52,141,768	43,483,715
Provision for loan losses	(3,150,943)	(2,923,698)
Accumulated commission in suspense	(2,700,716)	(2,388,945)
Loans and advances - net	46,290,109	38,171,072

Total non-performing loans and advances on which no income was recognized amounted to SR 8,706 million (1996 - SR 7,952 million). In addition to the above provision, the Bank maintains securities in kind against these loans and advances

6-2 Breakdown of loans and advances (gross) by major economic sector:

	1997	1996
a) Domestic		
a-1) Private sector		
Real estate	2,074,349	2,429,622
Agriculture	170,881	184,221
Manufacturing	1,696,380	2,124,456
Trading	10,864,197	9,663,945
Services and contracting	8,924,201	7,756,959
Other	1,371,775	1,980,333
a-2) Government, government agencies, quasi government and other public institutions	25,838,621	18,316,935
	50,940,404	42,456,471
b) International		
b-1) Private sector -		
Other	576,347	603,367
b-2) Government, government agencies, quasi government and other public institutions	396,710	228,318
b-3) Banks	228,307	195,559
	1,201,364	1,027,244
Total loans and advances - Gross	52,141,768	43,483,715

for the year ended 31 December 1997 (in thousands of Saudi Riyals)

6. Loans and advances, net continued

6-3 The movement in the provision for loan losses and accumulated commission in suspense:

Balance at beginning of the year:

Provision for loan losses

Accumulated commission in suspense

Amounts written off:

- In settlement for real estate which devolved to the Bank

- other settlements

Provided during the year

Commission suspended during the year

Balance at end of the year

7. Investment securities, net

a) Domestic

Shares and investment in companies

Fixed rate Government bonds

Floating rate Government bonds

Fixed rate treasury bills

b) International

Shares

Fixed rate treasury bills

Other fixed rate Government bonds

Fixed rate commercial bonds

Floating rate commercial bonds

Other investments (Murabaha)

Investment securities - net

The market/fair value of investment securities as at the balance sheet date amounted to SR 17,275 million (1996 - SR 20,732 million). These investments are intended for long term investment purposes, with debt securities to be held until maturity at which point the face value of such securities will be realized.

8. Fixed assets, net

	Land	Buildings	Furniture, cars and equipment	Total
Cost:				
Balance at beginning of the year	308,329	1,519,085	747,448	2,574,862
Additions	17,400	67,353	111,246	195,999
Disposals and adjustment	(350)	(48,614)	(16,727)	(65,691)
Balance at end of the year	325,379	1,537,824	841,967	2,705,170
Accumulated depreciation:				
Balance at beginning of the year	-	425,904	435,825	861,729
Additions	-	40,493	113,484	153,977
Disposals	-	(1,366)	(11,187)	(12,553)
Balance at end of the year	-	465,031	538,122	1,003,153
Net book amounts at 1997	325,379	1,072,793	303,845	1,702,017
Net book amounts at 1996	308,329	1,093,181	311,623	1,713,133

Notes to the financial statements

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for the year ended 31 December 1997 (in thousands of Saudi Riyals)

	1997	1996
9. Other real estate		
Balance at beginning of the year, net	1,033,182	889,408
Additions	23,766	171,267
Disposals, net	(17,940)	(19,675)
Depreciation on buildings for the year	(8,128)	(7,818)
Balance at end of the year, net	1,030,880	1,033,182
10. Other assets		
Customers' liabilities on acceptances	1,020,272	797,616
Accrued commission receivable	549,746	797,413
Other	617,571	459,212
Total other assets	2,187,589	2,054,241
11. Customers' deposits		
a) Domestic		
Current and call accounts	25,725,861	25,161,600
Saving	600,059	677,658
Time deposits	13,120,608	12,661,071
Other	2,680,612	3,242,281
	42,127,140	41,742,610
b) International		
Current and call accounts	61,423	46,509
Saving	14,172	10,504
Time deposits	19,347,291	16,069,505
Other	4,884	4,693
	19,427,770	16,131,211
c) Accrued commission payable	374,275	130,259
Total customers' deposits	61,929,185	58,004,080

Customers' deposits include foreign currency deposits equivalent to SR 15,452 million (1996 - SR 15,154 million).

Customers' deposits include an amount of SR 194 million (1996 - SR 383 million) representing liabilities arising from sales of fixed rate bonds under agreements for their repurchase at fixed dates in the future.

	1997	1996
12. Due to Banks		
a) Domestic		
Current and call accounts	264,536	104,891
Time deposits	7,534,719	4,846,816
	7,799,255	4,951,707
b) Foreign branches of domestic banks		
Time deposits	147,500	255,000
c) International		
Current and call accounts	1,404,232	984,824
Time deposits	4,457,102	5,161,745
	5,861,334	6,146,569
	13,808,089	11,353,276
d) Accrued commission payable	111,346	77,545
Total due to banks	13,919,435	11,430,821

Due to Banks includes an amount of SR 1,169 million (1996 - SR 2,691 million) representing liabilities arising from sales of fixed rate bonds under agreements for their repurchase at fixed dates in the future.

as at 31 December 1997 (in thousands of Saudi Riyals)

13. Other liabilities

	1997	1996
Acceptances outstanding	1,020,272	797,616
Profit for distribution to the partners	-	532,503
Proposed dividend to the shareholders (Note 18)	300,000	-
Zakat (Note 18)	29,963	24,287
Other	1,452,531	1,608,441
Total other liabilities	2,802,766	2,962,847

14. Share capital

The authorized and fully paid share capital at 31 December 1997 consists of 60 million shares of SR 100 each.

15. Statutory reserve

In accordance with the Banking Control Law, a minimum of 25% of the annual net income is required to be transferred to a statutory reserve until this reserve equals the paid up share capital of the Bank. This reserve is not available for distribution.

16. Earnings per share

The calculation of earnings per share is based on the net income for the year amounting to SR 1,043 million divided by 60 million shares. (1996 - not applicable as the Bank was a general partnership).

17. Statement of income for the period from 1 January 1997 up to 30 June 1997

In accordance with an agreement signed on 30 June 1997, the shareholders agreed that 1 July 1997 will be the effective date of the Bank's conversion to a Saudi Joint Stock Company and accordingly the net income for the period prior to the conversion from 1 January 1997 to 30 June 1997 (six months) is attributable to the partners in the general partnership. The following is a summary of the results of operations for this period:

Total operating income	2,753,426
Total operating expenses	(2,132,360)
Net income from operations	621,066
Other expenses	(18,801)
Net income before Zakat	602,265
Zakat	(12,003)
Net income	590,262

18. Proposed dividend and zakat

The Board of Directors has proposed a dividend amounting to SR 314.7 million to the shareholders for the period from 1 July 1997 to 31 December 1997 (six months). Zakat attributable to the shareholders amounting to SR 14.7 million will be deducted from the gross dividend resulting in a net dividend of SR 300 million at the rate of SR 5 per share net of zakat. The proposed dividend is included in other liabilities.

The Bank has finalized its zakat position and obtained a final clearance certificate up to 1995. The zakat assessment for 1996 is still in process with the Department of Zakat & Income Tax. The zakat liability for 1997 amounting to SR 26.7 million, out of which SR 12 million relating to the period prior to the conversion, has been charged to the statement of income (1996 - SR 24 million) and SR 14.7 million, relating to the period after conversion, is included with the proposed dividend in the statement of changes in shareholders' equity (note 2 - I).

19. Financial instruments**19.1 On balance sheet financial instruments - commission rate risk**

Commission rate risk is the uncertainty of future earnings resulting from fluctuations in commission rates. The risk arises when there is a mismatch in the assets and liabilities which are subject to commission rate adjustment within a specified period. The most important source of such rate risk is the Bank's lending, funding and investments activities, where fluctuations in commission rates are reflected in commission margins and earnings. The Bank also faces such rate risk in its trading portfolio, where rate changes may result in fluctuations in portfolio market values.

Commission rate gap is a common measure of rate risk. A positive gap occurs when more assets than liabilities are subject to rate changes during a prescribed period of time. A negative gap occurs when liabilities exceed assets during a prescribed period of time.

The commission rate gap position and term to maturity, based on contractual maturity dates or re-pricing, whichever is earlier for on balance sheet financial instruments, is as follows:

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31 December 1997

	Commission Sensitive			Non-commission Sensitive	Total
	Within 3 months	3 to 12 months	Over 1 year		
Assets					
Cash and balances with SAMA	-	-	-	2,899,160	2,899,160
Due from banks	11,493,292	1,824,133	-	827,358	14,144,783
Trading securities	-	184,394	705,399	430,707	1,320,500
Loans and advances, net	17,374,631	10,359,666	15,757,017	2,798,795	46,290,109
Investment securities, net	5,854,988	2,750,038	6,368,866	1,889,212	16,863,104
Fixed assets, net	-	-	-	1,702,017	1,702,017
Other real estate	-	-	-	1,030,880	1,030,880
Other assets	-	-	-	2,187,589	2,187,589
Total assets	34,722,911	15,118,231	22,831,282	13,765,718	86,438,142
Liabilities and shareholders' equity					
Customers' deposits	25,685,566	7,402,147	6,821	28,834,651	61,929,185
Due to banks	9,988,383	2,471,545	-	1,459,507	13,919,435
Other liabilities	-	-	-	2,802,766	2,802,766
Shareholders' equity	-	-	-	7,786,756	7,786,756
Total liabilities and shareholders' equity	35,673,949	9,873,692	6,821	40,883,680	86,438,142
On balance sheet gap position	(951,038)	5,244,539	22,824,461	(27,117,962)	
Off balance sheet gap position	1,655,000	(587,000)	(1,068,000)	-	
Combined gap position	703,962	4,657,539	21,756,461	(27,117,962)	
Cumulative gap position	703,962	5,361,501	27,117,962	-	

31 December 1996

	Commission Sensitive			Non-commission Sensitive Total	
	Within 3 months	3 to 12 months	Over 1 year		
Assets					
Cash and balances with SAMA	-	-	-	2,620,947	2,620,947
Due from banks	9,673,976	2,630,110	2,458	371,551	12,678,095
Trading securities	78,462	-	976,499	259,717	1,314,678
Loans and advances, net	22,740,074	6,186,627	6,605,014	2,639,357	38,171,072
Investment securities, net	4,199,247	1,450,014	13,069,129	1,748,850	20,467,240
Fixed assets, net	-	-	-	1,713,133	1,713,133
Other real estate	-	-	-	1,033,182	1,033,182
Other assets	-	-	-	2,054,241	2,054,241
Total assets	36,691,759	10,266,751	20,653,100	12,440,978	80,052,588
Liabilities and partners' funds					
Customer deposits	26,113,688	6,551,905	130,378	25,208,109	58,004,080
Due to banks	8,819,038	2,062,666	-	549,117	11,430,821
Other liabilities	-	-	-	2,962,847	2,962,847
Partners' funds	-	-	-	7,654,840	7,654,840
Total liabilities and partners' funds	34,932,726	8,614,571	130,378	36,374,913	80,052,588
On balance sheet gap position	1,759,033	1,652,180	20,522,722	(23,933,935)	
Off balance sheet gap position	550,000	(287,500)	(262,500)	-	
Combined gap position	2,309,033	1,364,680	20,260,222	(23,933,935)	
Cumulative gap position	2,309,033	3,673,713	23,933,935	-	

The off balance sheet gap represents the net notional amounts of off-balance sheet financial instruments, which are used to manage commission rate risk.

as at 31 December 1997 (in thousands of Saudi Riyals)

19-2 Off balance sheet financial instruments (contra accounts)

Term to maturity for off balance sheet items is as follows:

31 December 1997

	Within 3 months	3 to 12 months	Over 1 year	1997 Total
a) Contingent liabilities				
Letters of credit	2,274,636	824,143	197,794	3,296,573
Letters of guarantee	3,259,588	2,011,235	1,664,471	6,935,294
	5,534,224	2,835,378	1,862,265	10,231,867
b) Forward foreign exchange contracts				
Purchases	12,184,939	15,594,478	155,000	27,934,417
Sale	5,973,00	16,244,000	438,000	22,655,000
	18,157,939	31,838,478	593,000	50,589,417
c) Derivative				
Commission rate swap	9,624,130	2,695,086	606,320	12,925,536
Forward rate agreements	4,271,888	-	-	4,271,888
Futures	2,082,357	341,116	1,995,877	4,419,350
Currency options	5,209,360	157,000	12,000	5,378,360
	21,187,735	3,193,202	2,614,197	26,995,134
Total contra accounts	44,879,898	37,867,058	5,069,462	87,816,418

31 December 1996

	Within 3 months	3 to 12 months	Over 1 year	1996 Total
a) Contingent liabilities				
Letters of credit	2,807,494	1,019,009	420,514	4,247,017
Letters of guarantee	4,014,211	1,590,763	1,604,690	7,209,664
	6,821,705	2,609,772	2,025,204	11,456,681
b) Forward foreign exchange contracts				
Purchases	17,224,511	14,871,253	628,957	32,724,721
Sales	14,991,013	16,202,379	874,682	32,068,074
	32,215,524	31,073,632	1,503,639	64,792,795
c) Derivatives				
Commission rate swap	13,721,125	10,773,374	1,849,912	26,344,411
Forward rate agreements	5,640,988	3,731,250	-	9,372,238
Futures	633,750	2,396,250	765,000	3,795,000
Currency options	3,652,070	4,779,506	-	8,431,576
	23,647,933	21,680,380	2,614,912	47,943,225
Total contra accounts	62,685,162	55,363,784	6,143,755	124,192,701

The maturities set out in the above table are based on contractual re-pricing or maturity dates, whichever is earlier.

The fair value of off balance sheet financial instruments (contingent liabilities) is not significantly different from the book value.

In respect of the commitments for forward foreign exchange and derivative products, the amounts recorded are gross values and do not reflect the extent to which positions may offset one another. The amounts subject to market and credit risks are substantially smaller than the notional amounts.

Management does not anticipate any material loss as a result of these contingencies and commitments.

19-3 Foreign exchange position

The Bank had a net open foreign exchange position, principally in U.S. Dollars, of SR 2,168 million (1996 - SR 3,995 million).

20. Income from other real estate

	1997	1996
Loss on sale of other real estate	(54)	-
Rental income	27,597	25,433
Total gains on other real estate	27,543	25,433

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for the year ended 31 December 1997 (in thousands of Saudi Riyals)

21. Other income

	1997	1996
Gains/(losses) on investment securities	146,554	(21,776)
Gains on disposal of fixed assets	1,175	1,066
Income from trading securities	9,348	9,087
Other	9,317	30,915
Total other income	166,394	19,292

22. Transactions with related parties

During its ordinary course of business, the Bank transacts business with the major shareholders owning more than 10% of the Bank's share capital, some members of the Board of Directors and senior management and parties related to them. The balances from such transactions in the balance sheet were as follows:

	1997	1996
Loans and advances - against guarantees	101,822	53,519
Customers' deposits	155,002	59,402
Contra accounts - against guarantees	19,282	3,904

23. Investment services

The Bank provides certain investment management services to its customers. These services include the management of a variety of investment funds, some of which are in association with professional fund managers. The assets of these funds do not form part of the Bank's assets and, accordingly, are not included in these financial statements.

24. Assets and liabilities maturities

	1997		1996	
	Assets	Liabilities	Assets	Liabilities
Less than one month	41,876,100	53,717,563	31,340,526	52,875,735
One month to one year	16,544,893	22,121,301	19,288,997	16,428,788
One to five years	15,245,730	9,756	14,570,416	130,378
Over five years	7,850,933	-	10,052,093	-
	81,517,656	75,848,620	75,252,032	69,434,901

The above reflects the contractual maturities of the assets and liabilities, and accordingly does not represent the anticipated maturities based on the Bank's experience of maintaining deposits and managing its liquidity. The maturity profile is monitored by management on a daily basis to ensure adequate liquidity is maintained.

The above asset and liability amounts do not include fixed assets, other real estate and other assets and liabilities due to the special nature of these accounts.

25. Lease commitments

Total future lease commitments under non-cancellable leases of the Bank's buildings expire on the residual term of the leases during:

	1997	1996
Less than one year	13,186	11,144
One to five years	9,633	11,162
Over five years	1,907	2,610
	24,726	24,916

26. Year 2000

The Bank incurred certain expenditure during the year relating to modifications as deemed necessary to deal with the year 2000 issue in connection with computers. Further expenses relating to these costs will be expensed as incurred.

27. Comparative figures

Certain comparative figures have been reclassified to conform with the current year presentation.

Electronic Banking has been spreading rapidly worldwide and the move from traditional branch banking into electronic or automated banking will proceed at a faster rate in the years ahead. Less than 30% of all retail banking services in the US today are still carried out in the branch. In Saudi Arabia, the majority of all cash withdrawals are now performed on automated teller machines (ATMs) and the Kingdom has the largest ATM system in the Middle East. In 1989, four Saudi Banks had ATMs and there were just over 100 units in the Kingdom. By the end of 1997, there were around 1,600 ATMs and close to three million ATM cards in circulation. The ATMs are linked together through the Saudi Payments Network (SPAN), which can be used by the account holders of any bank.

The Saudi Arabia Monetary Authority (SAMA) has been promoting electronic banking in the Kingdom and its goal is to make Saudi Arabia one of the world's most progressive users of electronic payment systems. The increasing use of plastic cards started with Saudi Banks issuing debit ATM cards to account holders, free of additional charges, to withdraw cash and make balance enquiries from ATMs. The debit card has made cash accessible to a wide range of users beyond normal banking hours and reduced the need to visit banks for cash withdrawals. ATMs are placed at convenient, easily accessible locations frequented by the respective banks' account holders, such as shopping malls, department stores and recreation centres.

To motivate banks to expand their ATM base, SAMA has imposed a charge of SR4.60 for each withdrawal, which the customer's bank must pay for transactions at ATMs of other banks. Costs for banks with a large number of customers and a small number of ATMs can be significant. Banks, therefore, have been forced to increase the number of their ATMs.

The introduction of electronic cards in the Kingdom was facilitated by SAMA in 1990, with the setting up of the Saudi Payments Network (SPAN). SPAN provides electronic fund transfer services to the Kingdom's 12 banks, with an interface to process financial transactions originating in any of the ATM and POS terminals throughout the country. It also provides electronic authorization and interbank clearing and settlement. The central SPAN switch where these financial transactions are processed is located in SAMA's headquarters in Riyadh. A further extension of the SAMA service has been the global access system, by which customers can withdraw money from ATMs while travelling abroad.

Following the introduction of ATMs and the SPAN cards in the Kingdom, the need to hold cash for transaction purposes has been greatly reduced, as is evident from the declining ratio of currency outside the banking system to nominal GDP. The ratio dropped from 11.42% in 1990 to 7.5% in 1997 and is forecast to decline further in the years ahead. The inverse relationship between the 5% decline in the currency outside the banking system and the 37% increase in nominal GDP, between 1990 and 1997, can partly be explained by the number of the ATMs and SPAN cards in use.

Table 1

Quarterly average of SPAN activities

Years	Number of ATMs	Number of cards issued	Number of withdrawals	Number of inquiries	Number of points of sale
1994					
Q1	815	1,255,438	4,094,097	1,457,556	-
Q2	842	1,403,842	4,183,301	1,445,481	-
Q3	879	1,553,428	3,996,043	1,458,496	-
Q4	968	1,600,589	4,134,838	1,534,961	10,400
1995					
Q1	974	1,645,644	4,483,930	1,689,580	11,019
Q2	1,016	1,734,171	4,714,605	1,687,334	12,076
Q3	1,067	1,839,173	5,181,847	1,896,187	13,089
Q4	1,122	2,018,010	5,560,871	1,946,045	14,004
1996					
Q1	1,164	2,102,141	5,771,351	2,047,047	14,439
Q2	1,220	2,225,040	5,989,659	1,963,329	15,007
Q3	1,321	2,478,680	6,499,377	3,442,105	15,336
Q4	1,359	2,482,938	6,397,275	3,923,764	15,679
1997					
Q1	1,434	2,618,595	8,064,426	2,688,141	16,070
Q2	1,479	2,846,012	8,456,067	2,818,689	16,112
Q3	1,539	2,867,589	7,733,847	4,580,690	16,000

source: SAMA Money and Banking Statistics 3rd quarter 1997

SAMA started to implement a fast and innovative financial transaction system called Electronic Funds Transfer (EFT), to facilitate interbank payments and settlements. The EFT ensures better customer service by local banks, besides giving them an edge to compete in global financial markets. The system enables banks in Saudi Arabia to make and receive payments directly from their current accounts with SAMA, on a real time basis, and provides immediate and final payments to recipients. This move will help the treasurers of each member bank to have access to their real time position with SAMA throughout the day. In addition to the normal interbank payments, information will include settlement figures as they are produced from the SPAN network, the ESIS (Electronic Securities Information System) facility for share transactions, and all check clearings.

All customers who hold a SPAN card will be able to use their cards at any EFT-POS terminal in the Kingdom to pay for goods and services. Moreover, the electronic fund transfers and point of sale systems are spreading internationally and have become a convenient and secure payment method. An efficient, shared, national EFT-POS service in the Kingdom will provide a sound basis for longer term developments, leading the way to possible links in the future to an international network of EFT-POS services: enabling Saudi cardholders to enjoy the benefits of SPAN in other parts of the world. SAMA's objective is to have about 10,000 POS-terminals installed during the coming five years, and about one and a half million SPAN-POS cards issued by all banks in the Kingdom.

Although the SPAN service, and hence the SPAN-POS, has been designed specifically around the SPAN card, the technical approach is flexible enough to encompass any of the international card schemes, such as Visa and Mastercard. Representatives of these two international cards are already in discussion with SAMA to set up arrangements for incorporating them into the SPAN-POS service.

The number of credit cardholders in Saudi Arabia is growing rapidly. The estimate for 1997 is around 750,000, which is more than the rest of the Gulf, Iran and Jordan taken together. The Kingdom's banks are therefore aggressively marketing such credit cards as Visa and MasterCard. The Saudi public, especially amongst those who undertake bank transactions frequently, has readily adopted plastic money. The proportion of total transactions which banks now handle electronically (including ATM and POS transactions) has increased dramatically. For The National Commercial Bank, this proportion stood at around 65% in 1996, compared to just 5% five years ago.

During the six year period between 1991 and September 1997, the number of ATMs grew by almost 700%, from 200 to 1,539, an average growth of 40% per annum. The number of ATM cards issued to account holders has increased at a more rapid pace, growing from 252,156 at the end of March 1991 to 2,867,589 by the end of September 1997. This gives an average growth rate of around 50% per annum. The total number of cash withdrawals from ATMs rose from 298,309 in the first quarter of 1991 to 7,733,847 in September 1997, whereas the total number of inquiries increased from 96,734 to 4,580,690 (table 1).

Table 2

Number of ATMs in Saudi Arabia (by Province)

Years	March 1996	June 1996	September 1996	June 1997
Madinah	610	627	632	643
Southern Province	487	488	484	498
Riyadh	4,212	4,394	4,653	4,906
Northern Province	208	206	219	210
Qassim	318	319	325	344
Hail	107	112	120	134
Eastern Province	4,128	4,332	4,566	4,753
Western Province	4,414	4,557	4,632	4,621
	14,484	15,035	15,631	16,109

source: SAMA Money and Banking Statistics 3rd quarter 1997

Table 3

Years	March 1996	June 1996	December 1996	June 1997	% of total December 1996
Travel agencies	587	592	597	578	3.76
Household and Electric requirements	1,894	1,994	2,043	2,059	12.86
Restaurants	341	339	371	391	2.34
Jewelry shops	3,541	3,662	3,930	4,013	24.74
Rent-a-Car offices	357	351	342	330	2.15
Ready-made clothes stores	2,771	2,913	3,196	3,200	20.12
Medical services	812	838	886	902	5.58
Airlines	157	155	132	126	0.83
Supermarkets	1,560	1,620	1,701	1,737	10.71
Hotels	62	65	71	70	0.45
Others	2,402	2,506	2,618*	-	16.48
	14,484	15,035	15,887	13,406	100.00

source: SAMA Money and Banking Statistics 3rd quarter 1997

*Estimate based on growth in defined categories, September - December 1996.

The number of POS terminals rose from 10,400 in December 1994 to 16,000 at the end of 1996, whereas the number of POS operations surged from 275,090 to 741,853 during the same period. Sales conducted through POS terminals, on the other hand, rose from SR91 million in January 1995 to SR320 million in September 1997.

By mid 1997, the largest number of POS terminals (4,906) were located in Riyadh, accounting for 30.5% of the Kingdom's total (table 2). The second and third highest number of POS terminals were located in the Eastern (4,632) and Western (4,566) provinces respectively, accounting for 29.5% and 28.7% of the total. The remaining number of POS terminals were distributed in Madinah, Qassim, Hail and the Southern and Northern provinces.

Within the retail sector, jewelry shops have most readily installed POS terminals, giving buyers a sense of security as the amounts involved per item purchased can be significant. Accordingly, by mid 1997 around 4,013 POS terminals were installed in jewelry shops spread all over the Kingdom, accounting for 24.7% of the total (table 3). Garment stores accounted for the second largest number of POS terminals with a total of 3,200, representing 20.1% of the total. This was followed by retail outlets selling household consumer durables and electronics (12.8%), supermarkets (10.7%) and medical services (5.6%). Other businesses in the Kingdom which have installed POS terminals include travel agents (3.8% of the total), restaurants, (2.3%), car rental establishments (2.2%), airline offices (0.8%) and hotels (0.45%).

The Kingdom's banks are expected to expand the scope of ATM services in the future. Such services will include transferring remittances (using SWIFT transactions to accounts in foreign correspondent banks), settlement of utility bills, credit card payments, accepting cash from account holders and updating accounts, amongst other services. In order to develop customer loyalty, several companies in the Kingdom are likely to issue their own cards in the future. The Saudi Arabian Airlines took the lead in this direction when it became the first company in the Kingdom to issue its own card for frequent travellers. Saudia has enlisted NCB to develop business for its Alfursan Customer Loyalty Program and is targeting 20,000 account holders in the Kingdom.

In line with the trend worldwide, the growth of electronic banking in Saudi Arabia is inevitable. The only question is how fast it can be achieved. Although the infrastructure and technology required are already available and the telephone system is being expanded, laws need to be devised to protect banks involved in such transactions. The processing capability of SPAN needs to be enhanced in order to accommodate the increase in volume which is expected in the next five years.

SAMA has completed a study to introduce smart cards into the Kingdom. The existing SPAN cards will be upgraded to include a microchip, which will bring benefits of reduced fraud and lower transaction costs, besides making personal payment systems more efficient. These cards can be used for a number of different purposes and many Saudi companies have indicated their interest.

A major constraint to the growth of electronic banking services is the fact that a significant proportion of the population, especially women and the low income groups, are not aware of these services. Being a traditional society, used to conducting transactions in paper currency, there is a natural resistance to making the switch from paper to plastic or electronic money. Levels of awareness need to be raised for the public at large to fully appreciate the convenience that plastic money can provide. Card issuers need to generate the necessary level of trust, especially among the low and medium-income groups, to realize the market potential.

The continuing growth of electronic banking means that within the next five years, up to 70% of transactions conducted by a bank could be carried out via telephone, personal computer or smart cards. Banks who are willing to allocate the necessary resources to invest in technology and adopt a more aggressive approach to introducing new products are likely to reap the benefits of larger market share and boost long-term profitability.

Saudi Banks will need to continue to improve their services and keep pace with technology, or they will risk losing business due to the expected future opening up of the Kingdom's banking sector to international competition - in line with the provisions of GATT and the WTO. International Banks are expected to introduce newer technology products globally, and in the Saudi market, giving local banks an even greater challenge. The Kingdom's banks will therefore need to stay on top of technological developments in order to maintain their position in their own backyard.

Marketing of the new delivery mechanisms in Saudi Arabia, be it ATM, POS, credit or smart cards is absolutely vital for success. It is up to the individual banks to have the vision and courage to embrace and exploit the advantages that the new technologies can bring. The chief executives of banks must have the business acumen to decide and lead in this domain. Introducing new technologies is an expensive business and the shareholder must expect a reasonable return. Nevertheless, with education, persistence and appealing programs, change can be achieved and the Kingdom will be able to fulfill its all-encompassing dream of becoming one of the world's most progressive users of electronic payment systems.

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